

SURREBUTTAL TESTIMONY OF

DANIEL P. HUNNELL II

ON BEHALF OF

THE SOUTH CAROLINA OFFICE OF REGULATORY STAFF

DOCKET NO. 2019-281-S

IN RE: APPLICATION OF PALMETTO UTILITIES, INC. FOR

ADJUSTMENT (INCREASE) OF RATES AND CHARGES, TERMS AND

CONDITIONS, FOR SEWER SERVICE PROVIDED TO CUSTOMERS IN

ITS RICHLAND AND KERSHAW COUNTY SERVICE AREAS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Daniel P. Hunnell II. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the South Carolina Office of Regulatory Staff (“ORS”) in the Water Operations Department as a Senior Regulatory Analyst.

Q. DID YOU FILE DIRECT TESTIMONY AND ELEVEN (11) EXHIBITS RELATED TO THIS PROCEEDING?

A. Yes. I filed direct testimony and eleven (11) exhibits with the Public Service Commission of South Carolina (“Commission”) on May 26, 2020.

Q. DID YOU FILE REVISED DIRECT TESTIMONY AND ELEVEN (11) REVISED EXHIBITS RELATED TO THIS PROCEEDING?

A. Yes, I filed revised direct testimony and eleven (11) revised exhibits with the Commission on June 5, 2020.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony filed by Palmetto Utilities Inc. (“PUI” or the “Company”) witness Mark S. Daday and Gary Walsh.

Q. PLEASE RESPOND TO MR. DADAY’S CHARACTERIZATION OF YOUR DIRECT TESTIMONY RELATED TO THE COMPANY’S OFFER TO PHASE-IN A RATE INCREASE IN THIS CASE ON PAGE 2, LINES 5-7 OF HIS REBUTTAL TESTIMONY.

A. Mr. Daday attempts to reproduce a selected portion of a quote from my direct testimony while adding what appears to be his interpretation of the context of ORS’s position. However, the correct and complete quote is “The Company has offered in the Application Appendix 1 to phase-in its proposed increase over a three-year period. ORS supports the Company’s proposal to phase-in any increase authorized by the Commission. Further, the Company has not requested, and ORS recommends, that no carrying costs be added to the proposed phase-in of the increase.”

Q. PLEASE ADDRESS YOUR POSITION REGARDING THE COMPANY’S PROPOSAL TO PHASE-IN THE RATE INCREASE IN THIS CASE.

ORS adopted a supportive position of PUI’s phase-in proposal as it appeared the Company was making a genuine effort to mitigate the impact to customers of the rate increase. Given Mr. Daday’s rebuttal testimony, it is apparent the Company’s phase-in offer was based upon PUI receiving no less than 100% of its requested rate increase. ORS still supports the phase-in of any increase authorized by the Commission, and ORS recommends, that no carrying costs be added to the proposed phase-in of the increase.

Q. PLEASE ADDRESS MR. DADAY’S STATEMENT IN HIS REBUTTAL TESTIMONY ON PAGE 2, LINES 13-17 THAT ORS HAS AN INCORRECT UNDERSTANDING OF THE MATCHING PRINCIPLE AS IT RELATES TO PUI’S ALTERNATIVE PROPOSED IN APPENDIX 1 TO THE APPLICATION.

A. My concern regarding the alternative phase in plan relates to a violation of the matching principle under the National Association of Regulatory Commissioners (“NARUC”) Uniform System of Accounts (“USOA”), which the Company has been ordered by the Commission to use for rate and rate related matters.¹ Mr. Daday attempts to alleviate this concern by stating that under Generally Accepted Accounting Principles (“GAAP”), the alternative method would not violate the matching principle. While the Company may need to keep a separate set of accounting books and records in compliance with GAAP for reporting or tax purposes; for rate and rate related matters before the Commission PUI is required to be in compliance with NARUC USOA. Mr. Daday does not dispute the fact that under NARUC USOA the Company’s proposed alternative phase in method would violate the matching principle. ORS recommends the Alternative proposed by the Company in Appendix 1 to the Application be rejected by the Commission as the implementation would cause the Company to violate the matching principles required by the NARUC USOA.

Q. PLEASE RESPOND TO MR. DADAY’S DISAGREEMENT WITH ORS’S ADJUSTMENT TO BAD DEBT EXPENSE.

A. ORS’s calculation and recommendation for bad debt expense employed a five-year historic average to smooth out the anomalous uncollectable expense the Company has

¹ Order No. 2018-123; Docket No. 2017-228-S; Section IV Conclusion; Item No. 3; Page 26.

1 experienced over the last five years. Mr. Daday makes three arguments in his support of
2 using the Company's 2.5% bad debt percentage. First, Mr. Daday argues ORS
3 recommended the 2.5% bad debt percentage in the Company's last rate case and since the
4 Commission agreed to that bad debt percentage in Order Number 2018-155 the 2.5% rate
5 should continue to be used in this case. However, bad debt expense is like any other
6 expense the utility incurs, which may fluctuate over time, and the Company maintains the
7 burden of proof as to the reasonableness of its expense claims. In this instance, the
8 Company has provided no support for the continued use of the 2.5% bad debt percentage.
9 Nor has the Company demonstrated that the 2.5% bad debt percentage is known and
10 measurable.

11 Second, in his rebuttal testimony Mr. Daday claims the Company has experienced
12 a bad debt expense of 2.3% during the past three (3) years. Mr. Daday provides no
13 supporting documentation to support this percentage in his rebuttal testimony. In reviewing
14 the write off and revenue data provided by PUI, ORS is unable to validate Mr. Daday's
15 2.3% bad debt percentage during the past three (3) years. PUI provided data to ORS on
16 revenues and write offs on a yearly basis for the years 2015-2018 and for the periods of
17 September 1, 2014, to December 31, 2014 and January 1, 2019, to August 31, 2019. Based
18 on the data available ORS completed a review of bad debt expense on two periods of time
19 to provide the Commission with some context for the actual bad debt expense experienced
20 by PUI over time. ORS calculated the Company's bad debt percentage for the thirty-two
21 (32) month period ending August 31, 2019, and for the forty-four (44) month period ending
22 August 31, 2019. The bad debt percentage experienced by the Company during the thirty-

two (32) month period ending August 31, 2019, was 1.46% and the bad debt percentage experienced during the (44) month period ending August 31, 2019 was 1.98%.

Please see the charts below:

01/01/2017-08/31/2019 Write Offs	01/01/2017-08/31/2019 Revenues	Average Write Off%
\$716,101	\$49,141,367	1.46%

01/01/2016-08/31/2019 Write Offs	01/01/2016-08/31/2019 Revenues	Average Write Off%
\$1,276,586	\$64,555,091	1.98%

Third, Mr. Daday states that since March 1, 2020 the Company's cash collections have decreased 4% and 90-day old delinquent accounts have risen by 20% through May 29, 2020. Mr. Daday provides no supporting documentation to support this statement. ORS notes that on March 18, 2020 the Commission waived certain regulations related to Late Payment Charges and Procedures for Termination of Service for regulated utilities, including Wastewater Regulations 103-532.2 and 103-535, and directed that all regulated utilities suspend disconnection of service during the COVID-19 State of Emergency.² On May 14, 2020, the Commission vacated the previously granted waivers of regulations related to Late Payment Charges and Procedures for Termination of Service as well as the provisions of Order No. 2020-228 that directed all regulated utilities to suspend disconnection of service during the COVID-19 State of Emergency.³ It is unclear whether the trends in cash collections and delinquent accounts noted by Mr. Daday will continue as utilities take steps to a return to normal business operations. The Commission has allowed utilities the flexibility to offer longer deferred payment plans to customers who are unable

² Order No. 2020-228.

³ Order No. 2020-374.

1 to pay the full balance due for utility services.⁴ Given this additional flexibility, it is
2 premature to determine if those accounts currently 90-day past due will ultimately result in
3 bad debt write offs. Therefore, at this time, the impact of the recent trends in cash
4 collections and 90-day old delinquent accounts cited by Mr. Daday on bad debt are not
5 known or measurable.

6 **Q. PLEASE RESPOND TO MR. DADAY'S POSITION RELATED TO THE 8.5%**
7 **RATE THE COMPANY IS CURRENTLY USING IN ITS CALCULATION OF**
8 **THE TAX GROSS UP OF CONTRIBUTED PROPERTY.**

9 **A.** A review of the Settlement Agreement filed in Docket No. 2017-381-A indicates
10 there is no provision that specifies the 8.5% cost of capital is permanent or is not subject
11 to change. It is important to note that, when this Settlement Agreement was approved,
12 PUI's rates were set by the Commission under the operating margin method. In this instant
13 proceeding, PUI requested its rates be established by the rate of return method and the
14 Company's cost of capital going forward will be determined by the Commission in this
15 proceeding.

16 The 2017 Tax Cuts and Jobs Act ("TCJA") made changes to federal tax law that
17 have an impact on developers making infrastructure investments in the form of
18 Contributions in Aid of Construction ("CIAC"). CIAC represents the amount of money or
19 property advanced or contributed by a developer to ensure that the expansion of water or
20 wastewater service to new customers or new locations does not unfairly burden a utility's
21 existing customers. As a result of the TCJA, CIAC is now considered federal taxable
22 income to water and wastewater utilities. PUI has filed for a weighted cost of capital in

⁴ Order No. 2020-344.

1 the amount of 8.57%. Therefore, should the Company be awarded its requested cost of
2 capital in this case, or any other cost of capital greater than 8.5%, and the Company
3 continues to use the 8.5% rate in its Net Present Value (“NPV”) calculation for contributed
4 property; the Company would under-collect its federal tax obligation on any contributed
5 property obtained after the date of the Order in this rate case. Alternatively, should the
6 Company be awarded a cost of capital in this case that is less than the 8.5%, the Company
7 would over-collect its federal tax obligation from developers. To minimize the impacts to
8 the Company and the customers, the Company should be required to utilize the capital
9 structure approved by the Commission in this rate proceeding to calculate the NPV tax
10 multiplier percentage on property contributions. ORS recommends the Commission
11 approve the addition of the Tax Multiplier to the Company’s tariff with the changes noted
12 in my direct and surrebuttal testimonies.

13 **Q. PLEASE RESPOND TO MR. DADAY’S STATEMENTS REGARDING ORS’S**
14 **ADJUSTMENT FOR CUSTOMER GROWTH.**

15 **A.** The adjustment for customer growth is a standard ORS adjustment that is utilized
16 in rate cases for all types of utilities. Mr. Daday characterizes the adjustment as “seemingly
17 for the sole purpose of artificially lowering the amount of the proposed rate increase.” I
18 cannot agree with Mr. Daday’s statement because ORS applies the customer growth factor
19 to both the Company’s revenues and expenses. The Commission has a long-standing
20 practice of approving adjustments to utility revenues and expenses for customer growth.
21 This type of adjustment has been challenged at the South Carolina Supreme Court and the
22 Commission’s approval of a customer growth adjustment to revenues and expenses was
23 not overturned. The South Carolina Supreme Court approved the use of the customer

growth adjustment in its decision in Porter v. South Carolina Public Service Commission, 328 S.C. 222, 230, 493 S.E.2d, 96-97 (1997). The Court stated, “We find no abuse of discretion in averaging the amount of net income generated as a practical means of determining the adjustment for customer growth.” The Commission also approved the use of ORS’s customer growth adjustment in Docket No. 2004-357-WS. While the Commission originally disallowed ORS’s customer growth adjustment in that case; the South Carolina Court of Common Pleas in Case No. 2005-CP-40-6133 reversed the Commission’s findings related to ORS’s customer growth adjustment and directed the Commission to adopt ORS’s proposed adjustment, which the Commission did.

Q. PLEASE RESPOND TO MR. DADAY’S STATEMENTS REGARDING THE COMMISSION’S ORDER IN DOCKET NO. 2018-381-A REQUIRING PUI TO ESTABLISH A REGULATORY LIABILITY TO TRACK AND DEFER THE IMPACTS RESULTING FROM THE TCJA.

A. The Company has petitioned for rehearing in regard to Docket No. 2018-381-A. The Commission granted the Company’s petition for rehearing and instructed staff to set oral arguments. No date for oral arguments has been set as of this surrebuttal testimony. It is important to note the Commission has not vacated, stayed or suspended the provisions contained in Order No. 2018-308. Specifically, the Commission ordered the following:

[B]eginning January 1, 2018, regulatory accounting treatment is required for all regulated utilities for any impacts of the new law including current and deferred tax impacts. Therefore, the utilities should track and defer the effects resulting from the Tax Act in a regulatory liability account.

For water/wastewater utilities with operating revenues that are equal to or greater than \$250,000, the issue will be addressed in the next rate case or other proceeding.

1 The Commission ordered every South Carolina regulated utility, including PUI, to
2 specifically create a regulatory liability account and to track and defer the excess tax
3 expense it collected as a result of the TCJA. The Commission deferred making a decision
4 on the accuracy of the amount of the regulatory liability and the ratemaking treatment of
5 the regulatory liability until the next rate case.

6 In his rebuttal testimony, Mr. Daday acknowledges PUI did not create a regulatory
7 liability to comply with the Commission's Order. Likewise, the Company did not
8 acknowledge it created any type of liability account or deferred an amount equal to the
9 excess tax expense in its Application for rate increase or in the direct testimony of any of
10 its witnesses. Mr. Daday did provide a calculation in MD Rebuttal Exhibit 7 of what the
11 Company claims should be the effect of the TCJA. However, the calculation does not
12 reference a general ledger account and Mr. Daday provided no documentation to support
13 the calculation such that ORS could verify its accuracy.

14 **Q. DO YOU ATTEMPT TO ADDRESS THE COMPANY'S ASSERTIONS THAT THE**
15 **RETURN OF EXCESS CORPORATE INCOME TAX EXPENSE CONSTITUTES**
16 **RETROACTIVE AND SINGLE EXPENSE RATEMAKING AS PART OF YOUR**
17 **SURREBUTTAL TESTIMONY?**

18 **A.** No. The Company's claims and assertions that the return of excess corporate
19 income tax expense constitutes retroactive and single expense ratemaking are legal, not
20 accounting or rate design, arguments put forth by the Company. I do not address these legal
21 arguments as I am not a lawyer.

22 **Q. PLEASE RESPOND TO MR. DADAY'S AND MR. WALSH'S POSITION**
23 **REGARDING THE COMPLETION OF A COST OF SERVICE STUDY ("COSS")**

**AND ORS'S REQUEST THE COMPANY STUDY THE FEASIBILITY OF
TRANSITIONING TO VOLUMETRIC RATES.**

A. ORS recommends the Commission require PUI to complete a COSS and a review of its rate design. Both the COSS and the review of the rate design are necessary prior to further discussion of the feasibility of to determine transitioning to volumetric rates.

It is important to understand that a COSS and the rate design study are two different and separate activities. For example, a COSS can be completed without a rate design study being completed and vice versa. A COSS is completed to identify, among other things, if subsidization of any rate class may occur. A rate design study determines how to fairly allocate the revenue requirement assigned to a particular rate class between the members of that class.

Mr. Daday on page 18, line 20 of his rebuttal testimony states "PUI committed to conduct a study with respect to its rate design at the four voluntary Town Hall meetings we conducted for our customers on January 28 and 29, 2020" and on page 24, line 12 Mr. Daday states "the Company is in agreement that a COSS is appropriate". Mr. Daday, on pages 19 through 25 however, appears to disagree with ORS's recommendation that PUI complete a COSS and a study to determine the feasibility of transitioning to volumetric rates to be filed with its next base rate case.

Furthermore, Mr. Daday specifically appears to take issue with ORS's example of how a COSS could assist in determining the amount of the revenue requirement that should be assigned to the dump station. The dump station is owned by a subsidiary of PUI's parent company. PUI charges this subsidiary for 683 annualized equivalent residential customers ("ERC's"). Therefore, for billing purposes, PUI treats its sister subsidiary customer as if it

1 is 57 residential customers. The use of the dump station in my direct testimony provides
2 an example of how a COSS could assist the Company and Commission to determine the
3 proper allocation of the Company's revenue requirement. ORS did not express concerns
4 related to the Company's costs to operate the dump station. My direct testimony related to
5 the dump station demonstrates that a COSS would address and clarify the cost causation
6 of the dump station and not until the COSS is completed would it be known what effect
7 the dump station has on the revenue requirement.

8 Finally, in response to Mr. Daday's assertions that the recommendation for a COSS
9 made by ORS is based on the Commission's recent decision in another water and
10 wastewater rate case, I would point out that utilities share commonalities that may be
11 referenced by ORS when making recommendations. The concerns expressed by PUI's
12 customers about the current and proposed rate design led ORS to review existing
13 Commission decisions related to this topic. In doing so, ORS reviewed the customer
14 concerns expressed in the Blue Granite Water Company ("Blue Granite") recent rate case.
15 It is a fact that PUI and Blue Granite are NARUC Class A wastewater utilities and have
16 similar customer bases. Although, historically the Commission may have employed a flat
17 rate design for wastewater utilities, the Commission has clearly indicated a recent desire to
18 explore a change in that methodology. The Commission stated in Order No. 2020-306, "it
19 is reasonable and just for the Commission to find and to order that Blue Granite should
20 obtain water usage, or volumetric water consumption, data from entities providing water
21 service to Blue Granite's sewer-only customers so that this information may be used in the
22 development of a just and reasonable volumetric sewer service rate methodology to be
23 reviewed, and subject to approval, by the Commission in its next rate case." The

Commission's decision is well-reasoned, and the concerns expressed by PUI customers may be addressed by employing a similar approach. Therefore, ORS recommends PUI complete a COSS and investigate the feasibility of conversion of the Company's flat rate sewer rate design to a volumetric rate design within the same time frame as to when the Company files its next rate case.

Lastly, Mr. Daday in his rebuttal testimony included a letter from the City of Columbia affirming it is willing to provide water usage data to PUI. Should the Commission adopt ORS's recommendation to investigate the feasibility of conversion of the flat sewer rate design to a volumetric rate design, ORS recommends PUI incorporate the cost information from the City of Columbia into the Report to the Commission.

Q. PLEASE EXPLAIN THE PROCESS BY WHICH YOU PREPARED YOUR RECOMMENDATIONS IN THIS CASE.

A. I joined ORS in December 2019, as a Senior Regulatory Analyst. This case marks the first rate case assigned to me to review and examine. I have not worked on any prior cases involving PUI or its affiliates. As a new employee to ORS, I followed the normal and established ORS rate case preparation procedures necessary to collect relevant and specific information required to inform my review and recommendations. At the time I issued each discovery request, I concluded and determined that each request was appropriate, necessary and sought only relevant and appropriate data and information. ORS has a regulatory obligation to determine whether Company rate case proposals are consistent with Company claims as reflected in its books and records and with existing Commission decisions and precedent. In addition, based on my more than a decade of ratemaking and regulatory experience in preparing and presenting regulated utility company rate cases in seven

different state jurisdictions, the scope and number of requests for information in this case was both required and appropriate in order to support ORS's detailed review of PUI books and records. Finally, it is important to recognize that in this case PUI accepted without objection many of the results of my review, investigation and analysis found within my direct testimony. In contrast, PUI now recommends the Commission give virtually no weight to my direct testimony. That regulatory and evidentiary conflict is clearly reflected within Mr. Daday's rebuttal testimony on page 11, lines 10-11 as Mr. Daday directly utilizes a portion of my revised direct testimony in order to demonstrate that the Company is in compliance with all Commission and South Carolina Department of Health and Environmental Control requirements.

Q. PLEASE RESPOND TO THE ASSERTIONS MADE BY PUI ABOUT ORS STAFF'S CONDUCT DURING THE TIME PERIOD ORS WORKED TO FULFILL ITS DUTIES AND RESPONSIBILITIES UNDER S.C. CODE § 58-4-50 TO REVIEW, INVESTIGATE AND MAKE APPROPRIATE RECOMMENDATIONS TO THE COMMISSION WITH RESPECT TO THE RATES CHARGED OR PROPOSED TO BE CHARGED BY A UTILITY.

A. ORS's conduct was consistent with its statutory duties to review, investigate and make recommendations to the Commission reflecting the ORS mission to represent the concerns of the using and consuming public with respect to public utility services, regardless of the class of customer, and preservation of continued investment in and maintenance of utility facilities so as to provide reliable and high-quality utility services. I interacted and treated PUI in the same manner and fashion as I would all other utilities

during a rate case proceeding. ORS witness Dawn Hipp responds in more detail to PUI's assertions in her surrebuttal testimony.

Q. PLEASE RESPOND TO COMPANY WITNESS GARY WALSH'S ASSERTIONS IN HIS REBUTTAL TESTIMONY PAGES 3 THROUGH 6 THAT ACCOUNTING INSTRUCTION 21 OF THE NARUC UNIFORM SYSTEM OF ACCOUNTS DOES NOT APPLY TO PUI.

A. I disagree with Mr. Walsh's position. I have experience in the calculation of Utility Plant Acquisition Adjustments ("UPAA") and the preparation of acquisition accounting journal entries in accordance with NARUC USOA, and I have never seen Mr. Walsh's unique position in this matter. Mr. Walsh's on page 5, lines 5-7 of his direct testimony states "Accounting Instructions 21.B(1-5) is inapplicable, and thus there is no amount remaining in Account 104 which is required to be closed to Balance Sheet Account 114 as a utility plant acquisition adjustment." Mr. Walsh in his rebuttal testimony restates his positions offered in his direct testimony and offers no new information to demonstrate that Account 114 on the Company's Balance Sheet is exempt from the NARUC USOA Accounting Instruction 21. However, in his rebuttal testimony Mr. Walsh also states that should the Commission find that NARUC USOA Accounting Instruction 21 applies the Company should be granted a UPAA for the Palmetto of Richland ("PRC") assets which are in dispute in this case. However, in accordance with Accounting Instruction No. 21 there still would not be a UPAA to record to Account 114. The PRC assets are properly classified as contributions in Aid of Construction ("CIAC") by ORS witness Chuck Loy, therefore based on Accounting Instruction No. 21 the CIAC amount is required to be recorded to Account 271 and corresponding amortization of CIAC is to be recorded to

1 account 272. Thus, there would be no UPAA left in Account 104 to record to Account
2 114. The Company has not sufficiently explained the amount or reason for the amount the
3 Company's has recorded to Balance Sheet Account 114. ORS recommends the
4 Commission prohibit any rate recovery of the amount recorded in Account 114 and require
5 PUI to dispose of the balance in Account 114.

6 I also disagree with Mr. Walsh's analysis regarding the factors for when an
7 acquisition adjustment is appropriate. Mr. Walsh points to no evidence that customers in the
8 PRC service territory were experiencing any operational or service quality issues prior to the
9 acquisition transaction and there were no discernable changes in service quality as a result of
10 the former City of Columbia customers becoming PRC customers. In addition, PUI is not
11 asserting it paid a premium for the property.

12 **Q. WILL YOU UPDATE YOUR SURREBUTTAL TESTIMONY BASED ON**
13 **INFORMATION THAT BECOMES AVAILABLE?**

14 **A.** Yes. ORS fully reserves the right to revise its recommendations via supplemental
15 testimony should new information not previously provided by the Company, or other
16 sources, becomes available.

17 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

18 **A.** Yes, it does.